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NOVEMBER 2021

GREENWASHED?

THE INTENSIFYING SCRUTINY OF SUSTAINABILITY CREDENTIALS

Introduction

The phenomenon, commonly known as "greenwashing", where businesses overstate their green credentials deliberately or otherwise, is under ever-increasing scrutiny.

COP26 highlighted important global initiatives to support governments, activists and other stakeholders in detecting and enforcing against false sustainability claims.

This article provides a brief overview of the fast-evolving legal landscape and the potential enforcement risks.

Why businesses need to pay attention to greenwashing

Governments are interested in preventing greenwashing because it potentially diverts investment from genuinely sustainable activities and hampers the transition to a low carbon economy. As a result, greenwashing is increasingly likely to lead to material legal, reputational and ultimately financial repercussions for businesses. For a more detailed discussion of the increasing importance of aligning corporate purpose and values with tangible, sustainability goals, please refer to our podcast: '*ESG and business strategy: why corporate purpose is key to demonstrating authenticity*'.

All businesses are susceptible to the risk of being held accountable for greenwashing, but certain sectors, such as asset management, energy and transport, have so far attracted more attention from regulators and litigants. Businesses may face regulatory probes, civil claims and public backlash on the basis of alleged greenwashing for a wide range of reasons. These may include allegations of advertising the use of green technology that has not been implemented, presenting an activity as sustainable without a scientific basis, setting an ambitious climate-related target without outlining clear and effective steps to achieve it, and failing to disclose the financial or reputational impact of transitioning to a low carbon economy.

Businesses that make climate-related statements, such as well-publicised commitments by groups of businesses through the Glasgow Financial Alliance for Net Zero and The Climate Pledge for net zero carbon by 2040, can expect to face ongoing scrutiny by public and private actors who may seek to take action against green claims they perceive as misleading.

Public enforcement risks

The lack of a common sustainability disclosure standard has placed businesses at risk of making misleading statements. Amidst the plethora of voluntary disclosure standards and sustainability definitions, businesses face challenges in making accurate green claims, or in determining the extent of disclosure needed to substantiate those claims. However, recent developments are paving the way for some standardisation of the reporting and assessment of sustainability credentials. These developments are expected to reduce the scope for inadvertent greenwashing, while also making it easier for authorities to take action.

Notably, the International Financial Reporting Standards ("**IFRS**") Foundation announced on Day 3 of COP26 the long-awaited formation of a new International Sustainability Standards Board ("**ISSB**"). The ISSB will develop a "*comprehensive global baseline of high-quality sustainability disclosure standards*" to provide investors with the information needed to see how companies are addressing climate and other sustainability issues. Two climate and general disclosure requirements prototypes have been developed by the Technical Readiness Working Group ("**TRWG**") which consolidate key aspects of leading voluntary reporting standards into a single and enhanced set of recommendations for the ISSB to consider. By June 2022, the Value Reporting Foundation and Climate Disclosure Standards Board will be consolidated into the IFRS – thinning the existing 'alphabet soup'[1] of competing standards that add to the risk of inadvertent greenwashing.

The ISSB standard can be incorporated into domestic regulatory regimes, exceeded, or treated as a non-

[1] There are many existing reporting frameworks and initiatives, such as the Financial Stability Board's Task Force on Climate-related Financial Disclosures ("**TCFD**"), United Nations Climate Change Race to Zero, Principles for Responsible Investment, Institutional Investors Group on Climate Change and Value Reporting Foundation.

binding standard. The EU may exceed the ISSB standard if it is not considered ambitious enough, and the US Securities and Exchange Commission ("**SEC**") is expected to set its own climate reporting standards. Nonetheless, the ISSB will very likely rapidly set the global standard for climate and sustainability reporting, streamlining and formalising corporate sustainability disclosures.

Countries that intend to incorporate the ISSB standard into domestic law may already be laying the groundwork. The UK government plans to incorporate the ISSB standard into UK law, along with other sustainability-related disclosure requirements, by implementing an integrated framework of Sustainability Disclosure Requirements ("**SDR**") across the economy incrementally. "*The government expects that ISSB standards will form a core component of the SDR framework, and the backbone of its corporate reporting element*"; the SDR will "*bring together existing sustainability-related disclosure requirements under one integrated framework – building on leading global standards and best practice – and go further with new requirements*".[2] Further sector-specific requirements will also be produced by relevant government departments and authorities to regulate green claims made by businesses.[3]

In the meantime, regulators in a number of countries have already taken action. The US SEC formed a climate and ESG task force in its Division of Enforcement, with an initial focus on identifying material gaps or misstatements in issuers' disclosure of climate risks under existing rules. The UK Financial Conduct Authority ("**FCA**") published a discussion paper seeking to establish common standards, clear terminology and accessible product classification and labelling to help investors "*assess which products meet their needs and hold firms to account for their sustainability claims*".[4] The Swiss Financial Market Supervisory Authority FINMA published guidance on preventing and combating greenwashing in the fund segment, including in the advisory process and at the point of sale.

With increased regulation, authorities will also gain traction to investigate alleged greenwashing. Already, the Netherlands Authority for Consumers and Markets has launched investigations into allegedly misleading sustainability claims in the energy, dairy products and clothing sectors. The UK Competition and Markets Authority ("**CMA**") intends to investigate allegedly misleading green claims at the start of 2022 and take action against offending firms who do not abide by consumer protection law. The stakes of breaching UK consumer protection law may soon increase, in light of a proposed reform to allow the CMA to impose fines of up to 10% of global turnover.

Private enforcement risks

The regulatory developments impacting greenwashing make it an area ripe for private enforcement action, which could result in large awards of damages and negative publicity. Private actions may be brought on different legal bases, and by individual or group claimants, depending on the jurisdiction in which such claims are advanced. Complaints can also be pursued through National Contact Points.[5]

Claims in the UK can be brought by customers or shareholders on various grounds, including the tort of deceit or under relevant legislation. By way of example, such claims could be framed under the Consumer Protection from Unfair Trading Regulations 2008 relating to misleading actions or misleading omissions, or sections 90 and 90A of the Financial Service and Markets Act 2000 relating to misleading statements by listed companies in prospectuses, financial statements, circulars or other announcements.

Similar grounds may exist in other countries. For example, a non-governmental organisation ("**NGO**") brought a claim in the Federal Court of Australia in August 2021 alleging that Santos Ltd breached Australian corporate and consumer laws in making misleading and deceptive claims in its annual report that the natural gas it produces is a clean fuel and that it has a credible and clear plan to achieve net zero emissions. If the court finds in favour of the claimant, more private actors are likely to have renewed impetus to scrutinise annual reports and net zero transition plans to identify potential misstatements, which can form the basis of claims.

Private actors, such as NGOs and climate activists, may seek to bring claims on behalf of large groups of shareholders and consumers.[6]

[2] UK's HM Government, '*Greening Finance: A Roadmap to Sustainable Investing*', October 2021, pages 11-12.

[3] The UK government plans to consult on the SDR framework for UK-registered companies by 2022, and thereafter to consult on mandatory sustainability-related disclosures applicable to a broader group (including UK-listed companies, asset managers and occupational pension schemes) and mandatory sustainability-related labels for products, including investment products (HM Government, '*Greening Finance: A Roadmap to Sustainable Investing*', October 2021, pages 18-19).

[4] The FCA has also introduced TCFD-aligned disclosure rules and is consulting on draft guidance for complying with such rules. In addition, the FCA has published guiding principles for the design, delivery and disclosure of sustainable investment funds. It can exercise enforcement powers in the event of actual or suspected greenwashing (e.g. by imposing a financial penalty).

[5] Private actors can file complaints with a country's National Contact Point ("**NCP**") for the OECD Guidelines for Multinational Enterprises ("**Guidelines**"). For example, the UK NCP dealt with a complaint filed by ClientEarth in 2019, which alleged that BP "*misled the public in the way that it presented BP's low-carbon energy activities including their scale relative to the company's fossil fuel extraction business*".

[6] Climate-related group litigation cases have emerged in jurisdictions like Australia, Italy, the Netherlands and the US. In the UK, there are procedural mechanisms for bringing large group actions, but there is no opt-out style class action regime outside the sphere of competition law. For more information on

What's next: navigating rules, limiting risks and making a difference

The convergence of sustainability standards should minimise the risk of inadvertent greenwashing, but the widespread adoption of mandatory, internationally-compatible standards will also empower public and private actors to detect and take action on potentially misleading green claims.

The UK's implementation of an SDR framework, highlighted earlier, is expected to increase vigilance by businesses and enforcement actors, and reduce the scope for greenwashing in a number of contexts, including:[7]

- Corporate disclosure: as noted above, the government plans to adopt the ISSB standard;
- Green taxonomy in reporting: the government is developing a UK Green Taxonomy to introduce accepted definitions of which economic activities count as sustainable;
- Asset management disclosure: the government is developing requirements for asset managers and asset owners to disclose how they manage sustainability risks, opportunities and impacts;
- Investment products labelling: the government is developing a sustainable investment labelling regime, so that investment products are classified objectively against standard criteria;
- Transition plans: to encourage consistency and comparability in transition plans, the government intends to introduce regulations which incorporate standards from sources such as TCFD, Climate Action 100+ and the Institutional Investors Group on Climate Change; and
- ESG ratings monitoring: the government plans to establish regulatory oversight to ensure that ESG rating providers do not publish ratings that mislead investors.

Similar regulatory developments are expected to unfold across more jurisdictions globally. As the world awaits the emergence of a common baseline in sustainability standards, many businesses are already taking steps to manage greenwashing-related enforcement risks. For example, businesses should ensure that their sustainability statements are consistent with the latest climate science and take into account one of the existing reporting frameworks and best practices (see footnote 1 and our short video: '*Five things you should know about setting science-based targets*'). Businesses can look to the detail of the TRWG prototypes mentioned above to gain insight into what can be expected in the ISSB standard, and start building capabilities to meet the standard which could come into force as early as 2023. It is also important for businesses to establish effective internal controls to verify the accuracy of sustainability statements before they are made and to manage and monitor specific risk areas, such as the activities of third party providers and overseas subsidiaries, to ensure that these do not undermine the accuracy of statements made by the business on a group-wide basis.

Conclusion

Greater regulatory oversight, together with the increasing threat of enforcement actions by a wide range of public and private actors globally, should spur businesses to consider carefully whether green claims are credible and can be justified. As society develops an increasingly sophisticated understanding of climate-related issues, businesses must rise to the challenge of making well-founded sustainability statements against the backdrop of the fast changing legal landscape summarised above.

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shareholder group litigation, please see our previous podcast: '*The rise of shareholder group litigation and how to avoid it*'.

[7] Examples taken from HM Government '*Greening Finance: A Roadmap to Sustainable Investing*', October 2021.

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